

REFERENCE TITLE: investment tax; phaseout

State of Arizona
Senate
Forty-seventh Legislature
Second Regular Session
2006

SB 1546

Introduced by
Senators Martin, Bee, Blendu; Representatives Gorman, Pearce; Senator
Huppenthal; Representatives Knaperek, Yarbrough

AN ACT

AMENDING SECTIONS 43-1022 AND 43-1122, ARIZONA REVISED STATUTES; AMENDING
TITLE 43, CHAPTER 10, ARTICLE 3, ARIZONA REVISED STATUTES, BY ADDING SECTION
43-1026; RELATING TO CAPITAL GAINS TAXATION.

(TEXT OF BILL BEGINS ON NEXT PAGE)

1 Be it enacted by the Legislature of the State of Arizona:

2 Section 1. Section 43-1022, Arizona Revised Statutes, is amended to
3 read:

4 43-1022. Subtractions from Arizona gross income

5 In computing Arizona adjusted gross income, the following amounts shall
6 be subtracted from Arizona gross income:

7 1. The amount of exemptions allowed by section 43-1023.

8 2. Benefits, annuities and pensions in an amount totaling not more
9 than two thousand five hundred dollars received from one or more of the
10 following:

11 (a) The United States government service retirement and disability
12 fund, retired or retainer pay of the uniformed services of the United States,
13 the United States foreign service retirement and disability system and any
14 other retirement system or plan established by federal law.

15 (b) The Arizona state retirement system, the corrections officer
16 retirement plan, the public safety personnel retirement system, the elected
17 officials' retirement plan, an optional retirement program established by the
18 Arizona board of regents under section 15-1628, an optional retirement
19 program established by a community college district board under section
20 15-1451 or a retirement plan established for employees of a county, city or
21 town in this state.

22 3. A beneficiary's share of the fiduciary adjustment to the extent
23 that the amount determined by section 43-1333 decreases the beneficiary's
24 Arizona gross income.

25 4. The amount of any distributions from an individual retirement
26 account as provided for in section 408 of the internal revenue code or from a
27 qualified retirement plan of a self-employed individual as provided for in
28 section 401 of the internal revenue code to the extent that total adjustments
29 made pursuant to this paragraph in all tax years do not exceed the total of
30 all contributions made by the taxpayer to such plans prior to December 31,
31 1975, which were included in computing Arizona taxable income.

32 5. The amount of income on an installment receivable which is
33 recognized pursuant to the internal revenue code and which has already been
34 recognized on the death of the taxpayer for purposes of this title for tax
35 years ending before January 1, 1990.

36 6. Interest income received on obligations of the United States, less
37 any interest on indebtedness, or other related expenses, and deducted in
38 arriving at Arizona gross income, which were incurred or continued to
39 purchase or carry such obligations.

40 7. The amount of any income tax refunds which were received from
41 states other than Arizona and which were included as income in computing
42 federal adjusted gross income.

43 8. Annuity income included in federal adjusted gross income pursuant
44 to section 72 of the internal revenue code if the first payment with respect
45 to such annuity was received prior to December 31, 1978.

9. The excess of a partner's share of income required to be included under section 702(a)(8) of the internal revenue code over the income required to be included under chapter 14, article 2 of this title.

10. The excess of a partner's share of partnership losses determined pursuant to chapter 14, article 2 of this title over the losses allowable under section 702(a)(8) of the internal revenue code.

11. The amount by which the adjusted basis of property described in this paragraph and computed pursuant to this title and the income tax act of 1954, as amended, exceeds the adjusted basis of such property computed pursuant to the internal revenue code. This paragraph shall apply to all property which is held for the production of income and which is sold or otherwise disposed of during the taxable year other than depreciable property used in a trade or business.

12. The amount allowed by section 43-1024 for amortization, by a qualified defense contractor certified by the department of commerce under section 41-1508, of a capital investment for private commercial activities.

13. The amount of gain included in federal adjusted gross income on the sale or other disposition of a capital investment that a qualified defense contractor has elected to amortize pursuant to section 43-1024.

14. The amount allowed by section 43-1025 for contributions during the taxable year of agricultural crops to charitable organizations.

15. The portion of any wages or salaries paid or incurred by the taxpayer for the taxable year that is equal to the amount of the federal work opportunity credit, the empowerment zone employment credit, the credit for employer paid social security taxes on employee cash tips and the Indian employment credit that the taxpayer received under sections 45A, 45B, 51(a) and 1396 of the internal revenue code.

16. The amount of prizes or winnings less than five thousand dollars in a single taxable year from any of the state lotteries established and operated pursuant to title 5, chapter 5, article 1, except that all such winnings before March 22, 1983, including periodic distributions from such winnings made after March 22, 1983, may be subtracted.

17. The amount of exploration expenses that is determined pursuant to section 617 of the internal revenue code, that has been deferred in a taxable year ending before January 1, 1990 and for which a subtraction has not previously been made. The subtraction shall be made on a ratable basis as the units of produced ores or minerals discovered or explored as a result of this exploration are sold.

18. The amount included in federal adjusted gross income pursuant to section 86 of the internal revenue code, relating to taxation of social security and railroad retirement benefits.

19. To the extent not already excluded from Arizona gross income under section 112 of the internal revenue code, compensation received for active service as a member of the armed forces of the United States for any month during any part of which the member served in a combat zone as determined

under section 112 of the internal revenue code or in an area given the same treatment as a combat zone for purposes of section 112 of the internal revenue code.

20. The amount of unreimbursed medical and hospital costs, adoption counseling, legal and agency fees and other nonrecurring costs of adoption not to exceed three thousand dollars. In the case of a husband and wife who file separate returns, the subtraction may be taken by either taxpayer or may be divided between them, but the total subtractions allowed both husband and wife shall not exceed three thousand dollars. The subtraction under this paragraph may be taken for the costs that are described in this paragraph and that are incurred in prior years, but the subtraction may be taken only in the year during which the final adoption order is granted.

21. The amount authorized by section 43-1027 for the taxable year relating to qualified wood stoves, wood fireplaces or gas fired fireplaces.

22. With respect to a medical savings account established pursuant to section 43-1028:

(a) An eligible individual may subtract:

(i) The amount of contributions made by the individual's employer during the taxable year to the individual's medical savings account pursuant to section 43-1028 to the extent that the employer contributions are included in the individual's federal adjusted gross income.

(ii) The amount deposited by the individual in the account during the taxable year to the extent that the individual's contributions are included in the individual's federal adjusted gross income.

(b) The individual's employer may subtract the amount of contributions made by the employer to a medical savings account established on the individual's behalf to the extent that the contributions are not deductible under the internal revenue code.

23. The amount by which a net operating loss carryover or capital loss carryover allowable pursuant to section 43-1029, subsection F exceeds the net operating loss carryover or capital loss carryover allowable pursuant to section 1341(b)(5) of the internal revenue code.

24. Any amount of qualified educational expenses that is distributed from a qualified state tuition program determined pursuant to section 529 of the internal revenue code and that is included in income in computing federal adjusted gross income.

25. Any item of income resulting from an installment sale that has been properly subjected to income tax in another state in a previous taxable year and that is included in Arizona gross income in the current taxable year.

26. The amount authorized by section 43-1030 relating to holocaust survivors.

27. The amount authorized by section 43-1031 for constructing an energy efficient residence.

28. An amount equal to the depreciation allowable pursuant to section 167(a) of the internal revenue code for the taxable year computed as if the election described in section 168(k)(2)(C)(iii) of the internal revenue code had been made for each applicable class of property in the year the property was placed in service.

29. With respect to property that is sold or otherwise disposed of during the taxable year by a taxpayer that complied with section 43-1021, paragraph 26 with respect to that property, the amount of depreciation that has been allowed pursuant to section 167(a) of the internal revenue code to the extent that the amount has not already reduced Arizona taxable income in the current or prior taxable years.

30. With respect to property for which an adjustment was made under section 43-1021, paragraph 27, an amount equal to one-fifth of the amount of the adjustment pursuant to section 43-1021, paragraph 27 in the year in which the amount was adjusted under section 43-1021, paragraph 27 and in each of the following four years.

31. THE AMOUNT OF NET CAPITAL GAINS AUTHORIZED BY SECTION 43-1026.

Sec. 2. Title 43, chapter 10, article 3, Arizona Revised Statutes, is amended by adding section 43-1026, to read:

43-1026. Subtraction of net capital gains

A. IN COMPUTING ARIZONA ADJUSTED GROSS INCOME, A TAXPAYER MAY SUBTRACT FROM FEDERAL ADJUSTED GROSS INCOME A PERCENTAGE OF ANY NET CAPITAL GAIN INCLUDED IN FEDERAL ADJUSTED GROSS INCOME FOR THE TAXABLE YEAR AS FOLLOWS:

<u>TAXABLE YEARS BEGINNING:</u>	<u>THROUGH:</u>	<u>PERCENTAGE</u>
JANUARY 1, 2006	DECEMBER 31, 2006	10%
JANUARY 1, 2007	DECEMBER 31, 2007	20%
JANUARY 1, 2008	DECEMBER 31, 2008	30%
JANUARY 1, 2009	DECEMBER 31, 2009	40%
JANUARY 1, 2010	DECEMBER 31, 2010	50%
JANUARY 1, 2011	DECEMBER 31, 2011	60%
JANUARY 1, 2012	DECEMBER 31, 2012	70%
JANUARY 1, 2013	DECEMBER 31, 2013	80%
JANUARY 1, 2014	DECEMBER 31, 2014	90%

B. FOR TAXABLE YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2014, IN COMPUTING ARIZONA ADJUSTED GROSS INCOME A TAXPAYER MAY SUBTRACT FROM FEDERAL ADJUSTED GROSS INCOME ANY NET CAPITAL GAIN INCLUDED IN FEDERAL ADJUSTED GROSS INCOME.

Sec. 3. Section 43-1122, Arizona Revised Statutes, is amended to read:

43-1122. Subtractions from Arizona gross income; corporations

In computing Arizona taxable income for a corporation, the following amounts shall be subtracted from Arizona gross income:

1. The amounts computed pursuant to section 43-1022, paragraphs 8 through 15, ~~AND 28, 29 and 30~~ THROUGH 31. For THE purposes of this paragraph, "federal adjusted gross income" as used in section 43-1022 means "federal taxable income".

2. The amount of Arizona capital loss carryover as defined in section 43-1124 in an amount not to exceed one thousand dollars.

3. With respect to a financial institution as defined in section 6-101, expenses and interest relating to tax-exempt income disallowed pursuant to section 265 of the internal revenue code.

4. Dividends received from another corporation owned or controlled directly or indirectly by a recipient corporation. ~~"Control"~~ For THE purposes of this paragraph, "CONTROL" means direct or indirect ownership or control of fifty per cent or more of the voting stock of the payor corporation by the recipient corporation. Dividends shall have the meaning provided in section 316 of the internal revenue code. This subtraction shall apply without regard to ~~the provisions of~~ section 43-961, paragraph 2 and article 4 of this chapter. A corporation that has its commercial domicile, as defined in section 43-1131, in this state may subtract the full amount of the dividends. A corporation that does not have its commercial domicile in this state may subtract:

(a) For its taxable year beginning in 1990, an amount equal to one-half of the dividends.

(b) For taxable years beginning in 1991 and thereafter, the full amount of the dividends.

5. Interest income received on obligations of the United States.

6. The amount of dividend income from foreign corporations.

7. The amount of net operating loss allowed by section 43-1123.

8. The amount of any state income tax refunds received which were included as income in computing federal taxable income.

9. The amount of expense recapture included in income pursuant to section 617 of the internal revenue code for mine exploration expenses.

10. The amount of deferred exploration expenses allowed by section 43-1127.

11. The amount of exploration expenses related to the exploration of oil, gas or geothermal resources, computed in the same manner and on the same basis as a deduction for mine exploration pursuant to section 617 of the internal revenue code. This computation is subject to the adjustments contained in section 43-1121, paragraph 8 and paragraphs 9 and 10 of this section relating to exploration expenses.

12. The amortization of pollution control devices allowed by section 43-1129.

13. The amount of amortization of the cost of child care facilities pursuant to section 43-1130.

14. The amount of income from a domestic international sales corporation required to be included in the income of its shareholders pursuant to section 995 of the internal revenue code.

15. The income of an insurance company that is exempt under section 43-1201 to the extent that it is included in computing Arizona gross income on a consolidated return pursuant to section 43-947.

1 16. The amount of contributions by the taxpayer during the taxable year
2 to medical savings accounts established on behalf of the taxpayer's employees
3 as provided by section 43-1028, to the extent that the contributions are not
4 deductible under the internal revenue code.

5 17. The amount by which a capital loss carryover allowable pursuant to
6 section 43-1130.01, subsection F exceeds the capital loss carryover allowable
7 pursuant to section 1341(b)(5) of the internal revenue code.

8 Sec. 4. Legislative intent

9 The legislature intends to phase out the taxation of capital gains by
10 this state as provided by this act for the following reasons:

11 1. Capital flows to states and countries where the return on
12 investment is highest. The taxation of capital gains reduces the return on
13 investment.

14 2. Tax competition is one method to achieve a competitive edge in the
15 investment marketplace over other states and countries.

16 3. Emerging markets uniformly reduce their taxes on capital, including
17 Ireland, Russia, Ukraine and Hong Kong.

18 4. President John F. Kennedy observed in 1963, "The tax on capital
19 gains directly affects investment decisions, the mobility and flow of risk
20 capital ... the ease or difficulty experienced by new ventures in obtaining
21 capital, and thereby the strength and potential for growth in the economy."

22 5. Low taxes promote investment and innovation which lead to greater
23 prosperity and productivity.

24 6. Capital gains taxes are economically inefficient and have a
25 punitive effect on entrepreneurship, thrift and investment.

26 7. Capital is the engine of a growing economy, and taxes on capital
27 gains act as a choke on the economy.

28 8. Capital gains taxes cause distortions of the state's general fund
29 revenue condition by sustaining an artificially high level of annual
30 spending.

31 9. Arizona must recognize and alleviate the negative effect of capital
32 gains taxes on our economy.

33 Sec. 5. Retroactivity

34 This act applies retroactively to taxable years beginning from and
35 after December 31, 2005.